No. 13111

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

IDALIA O. FRATT,
*Appellant,*

vs.

JOHN R. ROBINSON *and* JANE DOE ROBINSON, *husband and wife, et* al,
*Appellees.*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

## APPELLEE'S PETITION FOR RE-HEARING

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## APPELLEES' PETITION FOR RE-HEARING

Apellees above named respectfully petition this Honorable Court for a re-hearing of the appeal of the above entitled cause and in support of their position represent to the Court as follows:

We reserve our argued position as to each of the points of appeal, but in this Petition address ourselves solely to that feature of the case which, in our opinion, effects a national public interest and which we believe the Court may be convinced that its result is based upon the application of incorrect legal principles.

Therefore, we limit our discussion to that phase of the case discussed on pages 3 to 7, of the Opinion, under the caption,

### "ARE THE ALLEGED FACTS OUTSIDE THE PURVIEW OF THE ACT?"

The decision in the instant case is of national public interest in that it affects the millions of persons buying and selling stocks and other securities. It is the only appellate decision passing upon the question of whether the Securities and Exchange Act of 1934 applies only to securities that at some time have been traded in or upon the over-the-counter markets or whether, to the contrary, the Act is broad enough in its scope (as the Court has now held) to cover all securities sales and transactions, including the isolated "over-the-fence" sales of stock in small family corporations where such

stock has never before, at any time, been traded upon any organized market.

It is the only appellate decision passing upon the important and far reaching question of whether the Securities and Exchange Commission, pursuant to the Act, has regulatory powers (as this Court has now indirectly held) over all stock transactions in the United States without limitation or whether the Commission's power is limited by the Act only to the regulation of securities that at some time have been traded in or upon securities exchanges or over-the-counter markets.

As this Court well knows there are millions of individual investors in the United States owning shares of stock in small, closely held, family corporations where such stock has never in its history crossed the threshold of a national securities exchange or an over-the-counter market.

The decision in this case is of great import to these millions of investors in such corporations in that it has now been held by an appellate court for the first time that such isolated sales are covered by the Act and *a fortiori* are likewise under the regulation of the Securities and Exchange Commission.

Also, the decision greatly affects the operation of the Commission because, as has already been said, it defines the regulatory powers of the Commission and broadens and increases these powers beyond what, we think, was the plain intent of Congress.

Because of the national importance of this question, its effect upon the many stockholders in small corporations, its determinative effect as to the regulatory jurisdiction of the Securities and Exchange Commission and, because we believe that the Court reached a wrong result, we respectfully urge that the Court, in the public interest, re-examine its position.

The opinion filed in the instant case adopts and approves the major premise of appellees that Congress, by the enactment of the Securities and Exchange Act of 1934, only intended, as said in Section 2 of the act, to regulate "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets," because on page 5 of the opinion it is said:

> "We think the whole tenor of the Act indicates that its operative procedure is by regulation of security-transfer businesses and persons who function in or through them."

The Court further adopts and approves appellees' second premise that the expression "over-the-counter" alludes to established businesses or brokers who handle security transfers off the regular stock exchanges and does not include the transfer of securities made without the aid of any intermediaries. On page 5 of the opinion it is further said:

> "That 'stock exchange' and 'over-the-counter markets' mean, in the Act, any security-transfer business wherein the business of marketing securities is conducted. *We think the authors of the Act*

> *realized that the remedy of the abuses sought to be applied by the Act would be more or less completely effective in the proportion of security-trading done on or through the established businesses.*" (Emphasis ours)

The Court completely rejected the argument or premise of the appellant and the Commission, as Amicus Curiae, that "over-the-counter" embraces every security not traded through a legal exchange, and further rejected appellant's theory that since in the preamble of the Act both expressions "securities exchange" and "over-the-counter market" are used, the two embrace every security transaction without limit. At page 5 of the opinion the Court definitely rejected appellees' premise in this regard when it said:

> "By what may seem to be a paradox we agree with the conclusion reached by appellant and the Commission while, *in general, disagreeing with their premise;* and we disagree with the conclusions reached by appellees while, in general, *agreeing with their assigned premise.*" (Emphasis ours)

At this point it is important to note that when the Court rejected appellant's premise in this respect the Court also rejected the basis for the holding in *Speed v. Transamerica Corp.*, D. Del., 1951, 99 F. Supp. 808.

After adopting appellees' premise and rejecting appellant's premise the Court then decided the case in favor of appllant for reasons which, we think, do not logically or legally follow.

It would appear that the Court reached the conclusion it did because it did not fully understand appellees' argument. The Court definitely seems to be of the opinion that appellees are arguing *that the transaction itself* must have occurred in or on a securities exchange or in or upon an over-the-counter market in order to come within the scope of the Act because on page 4 of the opinion the Court, to our complete surprise, said:

> "They (appellees) argue, from such premise, that to come under the Act at all a stock transaction must be through one or another of the established businesses."

THIS IS NOT APPELLEES' ARGUMENT AT ALL. As we said on page 10 of our brief:

> "Appellees are not arguing that the act does not apply to a transaction in a security unless the transaction itself took place on a national exchange or an over-the-counter market. If a stock is or was listed on a national exchange, transactions in that stock which take place off the exchange might well affect the price for transactions in that security on the exchange. The same is true of private transactions in a security which is commonly traded 'over-the-counter'."

It has always been appellees' position in this case that if a security has sometime in its history been traded upon a national exchange or an over-the-counter market that the act does apply, and we repeat, does apply, regardless

**of whether the particular alleged fraudulent transaction complained of was conducted on said organized markets or not.**

As we shall point out later the Court's apparent failure to correctly understand our position, as above set forth, *and the Court's mistaken belief that we were in fact arguing that the transaction itself must take place upon an organized market in order to come within the scope of the Act* has led the Court, in our opinion, to ground its decision upon an entirely unwarranted and unsound premise. We regret and apologize that our position was not made clear in our brief and in oral argument for as we see it, and as we shall presently demonstrate, it was the Court's misunderstanding of our position that led the Court to the conclusion which it reached.

Having mistaken our argument in this respect the Court, in its opinion, seems to hold that Section 10 of the Act must of necessity be held applicable to all securities transactions without limitation because by so holding, the Court has, on page 5 of the opinion, said that:

> " . . . those who desire to promote crooked deals would see little advantage in using devious methods to by-pass the security-dealing business houses under regulation."

In other words, the Court seems to conclude and bottom its decision upon the proposition that if Section

10 does not apply to every security transaction in the United States without limitation, that persons desiring to commit a fraud in the sale of securities would by-pass the securities exchanges and over-the-counter markets and thus escape the powerful deterrent of the Act and for this reason, says the court, Section 10 must be given this broad and sweeping interpretation in order to make the regulation of the organized securities market complete and effective.

However, had the Court correctly understood our argument at the outset we doubt very much if it would have grounded its decision upon the foregoing reasoning. *It must be clearly understood and remembered that the Act applies to any security that in its history has ever been traded on either a national exchange or an over-the-counter market, regardless of whether the particular fraudulent transaction took place on said markets or not.* Hence, had the Court correctly understood our position in this regard it would have been, in our poinion, most apparent to the court that "crooked deals" could not be promoted by by-passing exchanges and over-the-counter markets because, as we have pointed out, the Act would apply anyway for the reason that the stock involved had at some time in its history heretofore crossed the threshold of such organized markets.

In other words, the Court seems to be of the opinion that unless Section 10 of the Act is held to apply to every stock transaction in the United States without

limitation that the whole grand purpose of the Act to prevent fraud in the organized exchanges and markets would be frustrated in that persons desiring to promote so-called "crooked deals" would by-pass these organized markets and carry on their fraudulent transaction elsewhere. As we have pointed out, the Act applies to any transaction involving any security that heretofore had crossed the threshold of the organized markets regardless of whether the particular fraudulent transaction complained of occurred in or upon one of these organized markets or not. Hence, if one seeks to perpetuate a fraud or "crooked deal" with reference to such a security, said security having a past history in the organized markets, the Act applies regardless of whether the transaction itself actually took place in one of these markets. Thus, it becomes apparent that had the Court, in our opinion, correctly understood our position it would not have grounded its decision upon the proposition that Section 10 must be given a broad and sweeping interpretation "in order that those who desire to promote crooked deals would see little advantage in using devious methods to by-pass the security-dealing business houses under regulation."

In concluding its decision upon this phase of the case the Court on page 6 of the opinion briefly discussed the District Court cases of *Robinson v. Difford*, *Speed v. Transamerica* and *Kardon v. National Gypsum Company* and pointed out that these cases all reached the

same result by different reasoning. Then the Court says:

> "There appears to be logic in all of these roads to the common destination. There is one phase common to the reasoning of all cases; Sec. 10 is in aid of the end sought by the Act, to-wit: *the lessening of fraudulent and sharp practices in the securities market.*" (Emphasis ours)

If Section 10 of the Act, as said by the Court, "is in aid of the end sought by the act, to-wit: the lessening of fraudulent and sharp practices in the *securities market,*" (Emphasis ours) then it follows, as night the day, that the Act does not apply to a sale of stock that never in its history has been traded in any "*securities market.*" In other words, if Section 10 is an aid to the lessening of fraudulent practices in the "*securities market,*" how then can it be said that the Act applies to the sale of a security that has never been traded, in its entire history, in any "*securities market*"?

In the end, and regardless of the ingenious arguments of lawyers, it seems to us that the only question to be asked in this case is whether or not from a reading of the entire Securities and Exchange Act of 1934 it can be said, with reasonable certainty, that Congress intended to regulate and control the sale of every single share of stock or other security in the United States. This, to us, is the "nub" of the question.

Assuming that a father owned all of the capital stock in a closely held, family, incorporated butcher shop and

sold a share of stock to his son who desired to become a part owner in the corporation with his father; can it be said from a reading of the entire Act, that Congress intended to regulate this sale and subject the father and son to the jurisdiction of the Securities and Exchange Commission when said share of stock had never been sold in its entire history in any organized market such as a national exchange or over-the-counter market, merely because an instrumentality of interstate commerce such as the mails was used in closing the transaction? We think Congress never intended such a broad coverage.

Keeping in mind that Section 2 of the Act provides in part,

> "For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, . . . ",

we again direct the Court's attention to the colloquy which occurred on the Senate floor during debate on the bill between Senator C. C. Dill and Senator Alben Barkley as follows:

> "MR. DILL: The Senator is a lawyer and he knows that lawyers can make words mean almost anything. If it is the intent of this bill, not to include corporations whose stock is not so registered on an exchange or not dealt in over-the-counter,

of course, if that is the intent, he, as a legislator, only has to write it in the bill so that there cannot be any question.

"MR. BARKLEY: Section 2 of the bill itself says that only those are included in the proposed law. Why should anyone imagine that someone else will be included in it?" (78 Cong. Recrd, p. 8190).

We are making exactly the same point in this petition for rehearing as was made by Senator Barkley.

In the case now before the Court we are dealing with parties who are both residents of the State of Washington, involved in the sale of stock of a closely held family corporation which stock had never in its entire history been sold or traded in or upon a national exchange or any over-the-counter market. We respectfully submit that Congress, as was so bluntly stated by Mr. Barkley, never intended to regulate such a transaction.

In submitting the within petition we do not think it necessary, or perhaps even proper, to simply duplicate the materials and arguments contained in appellees' brief. However, because the cases of *United States v. Katz*, 271 U. S. 354. 46 S. Ct. 513, 70 L. Ed. 986, (1926), and *United States v. Jin Fuey Moy*, 241 U. S. 394, 36 S. Ct. 658, 60 L. Ed. 1061 (1916) announce principles of statutory construction which are so manifestly applicable, and we think decisive of the case at bar, we again, as an aid to the Court call attention to these cases. In *United States v. Katz, supra*, defend-

ants were indicted under the National Prohibition Act which provided: "No person shall manufacture, purchase for-sale, sell or transport any liquor." The Court held, in viewing the statute as a whole, that the above quoted Section only applied to persons authorized by other Sections of the Act to deal in liquor under Government Permit and did not mean "all persons" without limitation. The Court cited *United States v. Jin Fuey Moy* wherein it was there held:

> "This Court held that the words 'any person' not registered could not be taken to apply to any person in the United States, but must be read in harmony with the purposes of the Act to refer to persons required by law to register."

In the instant case Section 2 of the Securities and Exchange Act provides in part as follows:

> "For the reasons hereinafter enumerated *transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets* are affected with a national public interest which makes it necessary to provide for regulation and control of *such transactions* and practices and matters related thereto." (Emphasis ours)

Thus, Section 2 limits the entire application of the Act to "transaction in securities as commonly conducted upon securities exchanges and 'over-the-counter' markets and practices and matters related thereto."

Section 10 of the act uses the words "any security registered on a National Securities Exchange or any security not so registered."

It seems abundantly clear that the terms "any security registered on a national securities exchange or any security not so registered," as used in Section 10 must be construed in harmony with Section 2 of the Act which limits the application of the entire Act to securities as commonly conducted upon "securities exexchanges and over-the-counter markets." Applying the principles of statutory construction announced in the foregoing cases, Section 10 cannot possibly mean any security without limitation, but rather must logically mean any security which Congress was attempting to regulate as spelled out in Section 2.

In conclusion, appellees respectfully submit that in view of the national importance of the instant decision, its effect upon the many stockholders in small corporations, its determinative effect in defining and broadening the regulatory powers of the Securities Exchange Commission, that the Court, in the public interest, should re-examine its position and grant appellees a rehearing.

Respectfully submitted,

O. D. ANDERSON and J. P. HUNTER
*Attorneys for all Appellees*
*Except W. E. Difford.*

ALFRED J. SCHWEPPE and
M. A. MARQUIS,
*Attorneys for Appellee,*
*W. E. Difford.*

## CERTIFICATE

STATE OF WASHINGTON }
COUNTY OF SNOHOMISH } SS:

J. P. HUNTER, being first duly sworn on oath, deposes and certifies as follows: That he is one of the counsel of record of the appellees above named and makes this certificate in behalf of all counsel and in compliance with Rule number 25 of the Rules of the United States Court of Appeals for the Ninth Circuit; that the within Petition for re-hearing is, in his judgment, well founded and that it is not interposed for delay.

Dated this 30th day of April, 1953.

J. P. Hunter

Subscribed and sworn to before me this 30th day of April, 1953.

*Notary Public in and for the State of Washington, residing at Everett, Washington.*